IAG posts sound 1H17 financial results

Key financial indicators

- Insurance profit $571 million (1H16: $610 million)
- Reported insurance margin 13.5% (1H16: 14.9%)
- Underlying insurance margin[1] 12.6% (1H16: 14.2%)
- GWP $5.8 billion (1H16: $5.5 billion)
- Net profit after tax $446 million (1H16: $466 million)
- Cash return on equity (ROE) 14.8%
- Maintained interim fully franked dividend 13 cents per share (cps)

IAG today announced a 1H17 insurance profit of $571 million (1H16: $610 million) and a reported insurance margin of 13.5% (1H16: 14.9%), as it continued its drive to build an increasingly customer focused organisation.

Gross written premium (GWP) for the half was slightly above expectations at $5.8 billion, a 4.7% increase on 1H16 ($5.5 billion), predominantly due to rate increases to counter higher claim costs in short tail personal lines in Australia and New Zealand, and improved commercial pricing.

The company's underlying margin, IAG's preferred measure of business performance, was 12.6% (1H16: 14.2%). The slightly softer than expected operating performance was accompanied by a 0.7 percentage point adverse effect from the $40 million perils allowance increase to $340 million in the half.

IAG Managing Director and Chief Executive Officer Peter Harmer said the 1H17 result reflected a strong performance in IAG's consumer businesses, further signs that commercial pricing has passed the bottom of the cycle, and a focus on creating a more efficient business with customer needs at its core.

"This is a sound result for our core businesses in Australia and New Zealand, reinforced by the strength and integrity of our brands, our sharpened customer focus, and the quality and passion of our people.

[1] IAG defines its underlying insurance margin as the reported insurance margin adjusted for:
– Net natural peril claim costs less related allowance for the period;
– Reserve releases in excess of 1% of NEP; and
– Credit spread movements.

“In our Asian businesses, India moved into profit over the half but this was more than offset by increased competitive and claims pressures in Thailand and Malaysia.

“Underpinning our result is our strategy to make our customers feel safer and more confident through the products and services we deliver,” Mr Harmer said.

As outlined at the IAG strategy day on 8 December 2016, Mr Harmer said the company is driving customer and business benefits through its leading and fuelling themes.

Leading initiatives in place include a $75 million venturing fund to work with emerging and established business on new products and services, a Singapore-based InsurTech innovation hub to co-create solutions for future customer needs, and the increased use of aerial drones so customer claims are assessed quickly and safely after severe weather events.

“Through leading, we put customers at the centre of what we do by the enhanced use of technology, offering innovative new products through our core businesses, and identifying new ways to meet ever-changing customer needs.

“We are already seeing positive results, with our customers’ measure of our performance across our different brands above industry average. Our customer feedback is put into action through our ‘listen, learn and act’ model which enables us to implement improvements, from the front line through to senior management, to continuously drive better outcomes.”

Mr Harmer said to fuel its leading position, IAG was creating a more efficient organisation by simplifying the way it does business, optimising its resources, leveraging the benefits of its supply chain and continuing to build partnerships.

“Our optimisation program to simplify our operations and drive cost savings is well underway. We’re on track with our plans to partner with global experts to simplify processes and reduce complexity, and to significantly reduce our core claim and policy administration systems.

“We are doing this in the context of rapidly changing and heightened customer and societal expectations, so it’s more important than ever to focus on our core businesses while planning and implementing new ways of doing business,” Mr Harmer said.

The reported insurance margin of 13.5% (1H16: 14.9%) included:

- Net natural peril claim costs of $420 million (1H16: $278 million), which exceeded allowance by $80 million, with the New Zealand earthquake event in November 2016 contributing $117 million;
- A favourable credit spread impact of $5 million, compared to an adverse effect of $15 million in 1H16; and
- Higher than expected prior period reserve releases of $155 million, equivalent to 3.7% of NEP, up from $60 million (1.5% of NEP) in 1H16. These were predominantly derived from Australian long tail classes, principally CTP.

Net profit after tax was $446 million, 4.3% lower than 1H16 ($466 million). This included a significantly higher contribution from investment income on shareholders’ funds, which reflected stronger equity markets in the period.

IAG’s effective tax rate of 17% was higher than 1H16 (11%) but was lower than normal owing to approval by Singapore tax authorities of a lower applicable tax rate for reinsurance recoveries relating to the February 2011 Canterbury earthquake.

Dividend and capital position

The Board has determined to pay an interim fully franked dividend of 13 cents per ordinary share (1H16: 13 cps) on 30 March 2017, representing a cash payout ratio of 64.3%.

IAG's capital position remains strong with a Prescribed Capital Amount (PCA) multiple of 1.81 at 31 December 2016 compared to the company's targeted range of 1.4-1.6. The Common Equity Tier 1 (CET1) ratio was 1.09 against a target benchmark of 0.9-1.1.

The company's regulatory capital level was positively impacted by a tactical derivatives position within the company's investment portfolios which reduced the asset risk charge.

Excluding this, IAG's capital position comprised an adjusted PCA ratio of 1.70 and a CET1 ratio of 1.02.

After allowance for the interim dividend, the PCA multiple at 31 December 2016 would be at the upper end of IAG's benchmark range, while the CET1 multiple would be at the lower end of the equivalent target range.

DIVISIONAL RESULTS

The **Australian Consumer Division** (53% of Group GWP) produced a strong underlying margin of 14.1%, slightly lower than 15.5% in 1H16. Short tail home and motor lines continued to perform well, with higher than originally expected GWP growth of 6.6% reflecting the response to increased claim cost pressures. Long tail CTP GWP increased by over 12%, with IAG's entry into the South Australian CTP market from 1 July 2016 and rate increases in NSW to combat ongoing elevated claims frequency. Current year CTP profitability remained poor, but was consistent with the prior comparable period. The business' reported margin of 21.5% benefited from reserve releases in excess of expectations and a favourable perils outcome.

The **Australian Business Division** produced better-than-expected flat GWP with like-for-like GWP growth of over 4% for the half after allowance for the divestment of the Swann Insurance motor dealership business. Business retention levels exceeded expectations and higher average rates built on the steady momentum evident from the end of 1H16. A lower underlying margin of 8.8% (1H16: 10.7%) reflected past rate and volume declines, but was a modest improvement on 2H16. A lower reported margin of 7.1% (1H16: 8.4%) reflected adverse natural peril claim costs and slightly lower reserve releases.

New Zealand continued to deliver a strong underlying margin exceeding 15%, while bearing the impact of increased claim cost pressures and a soft commercial market. The reported margin of 4.3% included a net claim cost of approximately $117 million from the Kaikoura earthquake in November 2016. GWP growth of over 5% included a favourable foreign exchange translation effect, with local currency GWP growth closer to 1%. This comprised sound growth in personal lines offset by softer commercial lines, as underwriting disciplines were maintained.

Asia saw a 7.7% decline in consolidated GWP as lower premiums from intensified competition in Thailand were exaggerated by an adverse foreign exchange effect. Asia's overall earnings contribution fell to $2 million (1H16: $10 million), with contributions from Thailand and Malaysia down due to increased competitive and claims pressures. The combined contribution from the less-developed markets of India, Vietnam and Indonesia improved, as India moved into profit due to better claim and expense outcomes.

OUTLOOK

IAG has raised its FY17 GWP guidance to low single-digit growth, compared to its previous relatively flat growth prediction.

The slightly improved GWP guidance reflects:

- Higher than anticipated rate increases across short tail classes in response to claims inflation pressures which are expected to continue in 2H17; and
- Better than expected retention rates within the Business Division in 1H17.

IAG has maintained its FY17 reported margin guidance of 12.5-14.5%, with an expected outcome around the middle of the range. This incorporates:

- Slightly softer underlying profitability than originally anticipated, with 2H17 expected to be consistent with 1H17 in the face of continued claim cost pressures; and
- An increase in prior period reserve release expectations following the higher than expected 1H17 outcome.

The underlying assumptions behind the reported margin guidance are:

- Net losses from natural perils in line with allowance of $680 million (unchanged);
- Prior period reserve releases of at least 2% of NEP (previously at least 1%);
- No material movement in foreign exchange rates or investment markets in 2H17; and
- A small net negative from optimisation program initiatives, as early benefits are outweighed by related costs (unchanged).

It is too early to determine the net cost from the Northern Sydney hailstorm on 18 February 2017. In this guidance IAG has assumed the net cost from this event together with further perils in FY17 will be within the current perils allowance and available reinsurance cover.

IAG's reinsurance cover, post quota share, comprises:

- A calendar 2017 main catastrophe program which limits a first event exposure to $200 million;
- A calendar 2017 aggregate cover which provides $380 million of protection excess of $260 million, with qualifying events capped at $180 million excess of $20 million per event; and
- An FY17 specific cover which provides $96 million of protection directly above the $680 million perils allowance.

While IAG now expects prior period reserve releases of at least 2% of NEP in FY17, it remains IAG's belief that long term reserve releases of around 1% of NEP are a recurring feature of its reported operating results in benign inflationary periods.

Mr Harmer said the business is well positioned for future success as it maintains its strong focus on customer needs, responds to the dynamic external environment – where advances in technology and the use of data are changing customer expectations – and through its significant business change program.

UPDATE ON LICENCE CONSOLIDATION PROJECT

IAG is continuing work to consolidate its Australian insurance licences from nine to two. The consolidation will transfer seven separate entities into a related business, Insurance Australia Limited. The proposed transfer will have no impact on policyholders and will not change the terms of their policies or have any impact on claims, with all policies continuing to operate and be renewed in the usual way.

The Federal Court hearing for confirmation of the seven schemes is expected to take place in July 2017, with the transfer, if approved, to take effect from 1 August 2017. Policyholders can find out more about the schemes at www.iag.com.au/licences or from the information line on 1800 907 424.

IAG FINANCIAL PERFORMANCE

GROUP RESULTS	1H16 A$m	2H16 A$m	1H17 A$m	1H17 vs 1H16 Mvt
Gross written premium	**5,543**	**5,824**	**5,802**	**+4.7%**
Gross earned premium	5,734	5,677	5,868	
Reinsurance expense	(1,632)	(1,551)	(1,624)	
Net earned premium	**4,102**	**4,126**	**4,244**	**+3.5%**
Net claims expense	(2,589)	(2,808)	(2,625)	
Commission expense	(423)	(386)	(416)	
Underwriting expense	(654)	(653)	(669)	
Underwriting profit	**436**	**279**	**534**	
Investment income on technical reserves	174	289	37	
Insurance profit	**610**	**568**	**571**	**-6.4%**
Net corporate expense	(14)	(207)	(4)	
Interest	(51)	(48)	(51)	
Profit/(loss) from fee based business	10	(8)	(1)	
Share of profit from associates	8	12	9	
Investment income on shareholders' funds	38	59	105	
Profit before income tax and amortisation	**601**	**376**	**629**	**+4.7%**
Income tax expense	(67)	(151)	(109)	
Profit after income tax (before amortisation)	**534**	**225**	**520**	
Non-controlling interests	(40)	(37)	(45)	
Profit after income tax and non-controlling interests (before amortisation)	**494**	**188**	**475**	
Amortisation and impairment	(28)	(29)	(29)	
Profit attributable to IAG shareholders	**466**	**159**	**446**	**-4.3%**

INSURANCE MARGIN	1H16 A$m	1H16 %	1H17 A$m	1H17 %
Management reported insurance margin	610	14.9	571	13.5
Net natural peril claim costs less allowance	(22)	(0.6)	80	1.9
Reserve releases in excess of 1% of NEP	(19)	(0.5)	(113)	(2.7)
Credit spread movements	15	0.4	(5)	(0.1)
Underlying insurance margin	584	14.2	533	12.6

About IAG
IAG is the parent company of a general insurance group (the Group) with controlled operations in Australia, New Zealand, Thailand, Vietnam and Indonesia. The Group's businesses underwrite over $11 billion of premium per annum, selling insurance under many leading brands, including: NRMA Insurance, CGU, SGIO, SGIC, Swann Insurance and WFI (Australia); NZI, State, AMI and Lumley Insurance (New Zealand); Safety and NZI (Thailand); AAA Assurance (Vietnam); and Asuransi Parolamas (Indonesia). IAG also has interests in general insurance joint ventures in Malaysia and India. For further information please visit www.iag.com.au.

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